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SUBJECT: 2007 a Good Year for Philippine Economy, and for USG
Economic Efforts in the Philippines

Summary

¶1. (SBU) Embassy Manila's long-term efforts to promote economic reforms and improved governance are one factor behind the increased performance and resilience of the Philippine economy. Although statistics for the entire year are not yet available the economy is on track to grow at around seven percent for the entire year, unemployment and inflation are down, government revenues up. This has also been a significant year in our promotion of economic reforms, and in civil aviation safety, intellectual property rights, and marine science efforts. End Summary.

Excellent Overall Macro Performance

¶2. (U) U.S. economic policy towards the Philippines has clearly and consistently emphasized domestic Philippine economic growth with equity as the best way of advancing larger U.S. interests in the region. Over the past several years, the Philippine economy has demonstrated a newfound strength and resilience, and foreign investors have demonstrated increased confidence in the country's future. January-September Gross Domestic Product (GDP) expanded by 7.1% year-on-year, and is on track to exceed the high end (6.7%) of the Government's targeted growth range.

¶3. (U) Full-year growth of near 7% will be the economy's strongest expansion in three decades, capping nine consecutive quarters of growth at greater than 5%. Personal consumption continued to fuel the economy's growth on the demand side -- helped by robust remittances from overseas Filipino workers. Government construction expenditures (up 30% in real terms) also contributed, reflecting a deliberate policy enacted after the passage of enhanced tax measures. Private construction investments (up 10%) broke from two consecutive years of negative growth, boosted in part by overseas workers' investments in real estate, the demand for office space from the booming business process outsourcing industry, and lower interest rates.

¶4. (U) The balance of payments surplus was \$7.8 billion through October and is poised to end 2007 at an all-time high on the back of remittances and higher net inflows of foreign portfolio and direct investments. Remittances from overseas workers are expected to exceed \$14 billion by yearend. Net foreign portfolio investment

increased to an estimated \$3.7 billion through November, up 76% year-on-year. The Central Bank estimated net foreign direct investment at \$1.9 billion through September, up 22.3% from 2006's comparable nine-month level. The Central Bank's gross international reserves reached a new high of \$32.5 billion as of end-November, equal to about six months of goods and service imports.

15. (U) The Philippine Government is on track towards staying within the 1%-of-GDP fiscal deficit ceiling programmed for 2007. For a second consecutive year, the deficit-reduction program and improved financial performance of other public sector entities have yielded surpluses for the consolidated public sector. Although still high, the debt of the consolidated public sector has declined to under 80% of GDP, from 2003's peak 118%-of-GDP ratio. Improved public sector finances and lower inflation have helped bring down domestic interest rates to a record low and consumer price inflation will average below 3% during 2007.

16. (U) From January through mid-December 2007, the peso strengthened by 18% versus the US dollar, the most among regional currencies. The Government pre-paid foreign denominated obligations, relaxed ceilings for foreign exchange purchases, and built-up international reserves, partly to stem the peso's rapid appreciation. As of mid-December, the Philippine Stock Exchange index was up nearly 22% for the year. As of September 2007, the share of non-performing loans and foreclosed assets to total commercial banking system assets had declined to 5.3% (from 6.3% at the end of 2006 and May 2002's 15.1% Asian crisis peak).

Economy demonstrated Ability to Withstand Shocks

17. (SBU) These positive macro economic developments have occurred in spite of factors that in the past might have shaken business

confidence or dampened performance, including rising fuel prices, repeated corruption allegations against the Arroyo Administration, coup plots, terrorist bombings, an unruly legislature, and an irresponsible press. The Government will beat its deficit target this year despite under-performing tax collections if only because of strong privatization receipts and lower-than-projected debt payments.

Trade Healthy

18. (U) The United States continued to be the Philippines' largest trading partner in 2007, accounting for 16.9% of Philippine exports, and 14.6% of its imports on a value basis. Two way merchandise trade between the United States and the Philippines amounted to \$12.6 billion over the first nine months of 2007. The Philippines is the fifth largest beneficiary of the General System of Preferences, with \$928 million in Philippine goods entering the United States under the program through September, or 13.4% of all Philippine exports to the United States.

USG Reform Accomplishments

19. (SBU) Progress was made on many of our priority areas for economic reform this year. Among the most important of the successes we shared with our Philippine allies were:

-- Energy Privatization: 2007 was a banner year for Philippine power privatization. Thirty-nine percent of the government's electric generation capacity has now been privatized, up from 11% at the start of the year. The 25-year concession for the National Transmission Company, TransCo, was sold for \$3.95 billion. This is a record amount for a government asset sold in the Philippines and will be helpful in retiring the debt. We will continue to press for the government to meet its statutory obligation to sell off 70% of capacity and liberalize the sector.

-- Civil Aviation Liberalization: Though President Arroyo did not sign a decree re-liberalizing service to the former Clark airbase,

as many had hoped, she instead instructed her negotiators to agree to a significantly liberalized civil aviation agreement with South Korea, one of the most important sources of tourists to the Philippines. The fight over liberalization of this sector will continue in 2008.

-- Fiscal Reform and the Fight Against Corruption: The Millennium Challenge Corporation Threshold Program for the Philippines, focused on increasing transparency and effectiveness in revenue collection and improving the work of the anti-corruption institution made significant progress. The project is on track to meet most key indicators. USAID assistance programs also made a significant and quantifiable contribution to revenue collection.

-- Infrastructure and Education spending: As a result of the improved fiscal situation and at the urging of the Embassy and many of our partners in policy advocacy, the government has significantly increased funding for both primary education and infrastructure, both of which have been starved for funds in recent years.

Philippine Civil Aviation Safety Regulation Hit

¶10. (SBU) The year ended with the FAA on the verge of announcing a downgrade to Category 2 under its International Aviation Safety Assessment program. Post has worked with the government and industry since the initial FAA assessment visit in July to build understanding of the situation and a commitment to reform. The FAA team that announced the decision to Philippine officials in November noted that the Filipinos had been exceptionally well-prepared for the downgrade news by Post and had given serious thought to how the problems could be remedied. Even before the FAA team delivered its assessment, the Philippine House of Representatives passed legislation to create a new Philippine Civil Aviation Authority based on international recommendations. In 2008 we will be monitoring the Philippine plans to regain Category 1 status and working closely with Philippine officials, industry and the FAA to help them achieve that goal.

More Nuanced Picture on IPR

¶11. (U) Intellectual property rights protection remained a significant concern in 2007. While the Philippine government promoted IPR protection, and seized some IPR infringing materials including clothing, software, and optical discs, the lack of prosecutions and convictions continues to be a major problem. We maintain our aggressive outreach in engaging industry, the administration and congress on the "Cheaper Medicines Bill" to minimize impact on U.S. industry and ensure that any legislation passed is consistent with Philippine international commitments and U.S. policy. We played a key role in quashing a Department of Justice decision which would have allowed Philippine pirates to re-broadcast with impunity U.S. television content without authorization. During 2007, several dozen Philippine government officials involved in intellectual property rights protection participated in U.S. training programs and officials from the Office of the United States Trade Representative emphasized IPR during two visits to Manila, as did the regional attach of the U.S. Patent and Trademark Office.

Major Accomplishments in Marine Science

¶12. (U) We played a key role in assisting marine scientific research projects in Philippine waters in 2007. The scientific research highlight was the successful deep sea exploration of the Inner Space Speciation Project conducted by scientists from Woods Hole Oceanographic Institution and National Geographic. The project received extensive local and international press coverage and will be on National Geographic Television and in the December 2008 issue of National Geographic Magazine.

¶13. (U) We coordinated officials from the United States Department

of Agriculture, Federal Communication Commission, and the Economic Bureau's Office International Information and Communications Policy who conducted training and consultations on delivering high-speed internet in rural areas. Post convened intergovernmental and non-governmental stakeholders to formulate an oil spill plan. We hosted Science Fellows from the U.S. Environmental Protection Agency to acquaint the Department of Science and Technology with U.S. technology transfer laws and to assist Ateneo University, the Manila Observatory, non-governmental organizations interested in coastal conservation, and the Philippine Tropical Forest Conservation Foundation in pinpointing environmental problems in the Philippines via satellite mapping.

Progress in Combating Terror Finance

¶14. (U) Post assisted in training almost 1,000 Philippine students in Anti-Money Laundering and Countering Terrorism Financing in 2007.

The Human Security Act which passed congress in June gives Philippine officials valuable new law enforcement tools for collecting information on possible sources of financing for terrorism. In November, Philippine officials expressed a new determination to independently nominate several Philippine nationals involved in terror finance to the United Nations 1267 Committee.

Comment

¶15. (U) Although the general macroeconomic outlook has improved significantly, the Philippines continues to face important challenges and must sustain the reform momentum to catch up with its regional neighbors and translate current optimism into the long-term confidence needed for higher investment levels, sustained high growth, employment generation, and poverty alleviation. Sustaining longer-term fiscal stability that allows for higher spending on infrastructure and social services will require more aggressive efforts to strengthen tax collection and administration as privatization receipts are not a sustainable revenue source. The Philippines continues to struggle with slipping competitiveness and anti-corruption rankings because other countries are moving more aggressively to address problems in these areas.

Embassy Manila's detailed economic reform agenda can be accessed on the classified Intellipedia at www.intelink.sgov.gov/wiki/Philippines_Economic_Priorities.

Kenney